A Case Study of Internal Control of *ST Baoqian
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Abstract. Since the establishment of Shanghai and Shenzhen Stock Exchanges, there are more than 3,400 listed companies in China, but there are not a few companies delisting due to various problems every year. The research shows that the lack of effective internal control of listed companies is the deep-seated reason for their delisting. Once there are problems in the company's internal control, it will be difficult for the company's business activities to be effectively supervised, and the safety of assets will not be guaranteed. Good internal control is an important link for listed companies to seek sustainable and stable development and achieve business objectives. As an essential part of modern company management, internal control also plays an important role in improving company management level and business performance. *ST Bao Qian is a typical case of failure of internal control and lack of supervision and management of enterprise operation, which has been suspended from listing and is in a precarious state. Taking*ST Bao Qian as an example, based on the internal control theory, this paper deeply explores the internal control problems of *ST Bao Qian and analyzes their causes, and then gives some improvement suggestions, in order to improve the internal control problems of *ST Bao Qian and provide suggestions for other companies.

1. Introduction

With the continuous development of contemporary economy, China's booming capital market has brought opportunities for the development of listed companies, and the number, scale and quality of domestic listed companies are constantly developing. However, there are many problems in the development of listed companies, such as the huge loss of overseas investment of China Aviation Oil, the fraud of Wanfu Biotechnology and the fraud of Xintai Electric, etc., so the number of delisted companies is also increasing. In the process of seeking for reasons, strengthening supervision and exploring preventive measures, the relevant supervision departments found that the problems of internal control were the main reasons leading to the failure of business and the illegal activities, and most of the enterprises with major defects in internal control have problems such as incomplete understanding of income policy, lack of division of staff responsibilities, and insufficient accounting information\textsuperscript{1}. Therefore, establishing an effective internal control system and optimizing internal control are particularly important for reducing financial problems of listed companies, improving operational efficiency and achieving business objectives. For example, some enterprises usually ignore the control of asset procurement. In order to prevent unreasonable asset procurement, enterprises should formulate corresponding procurement management system and strengthen the management of procurement budget\textsuperscript{2}. In addition, enterprises need to connect with each control process when making budget, in order to achieve a scientific budget, so as to promote the
implementation of all aspects of internal control\(^3\). Now, internal control has gradually become an important weapon for enterprises to prevent risks and improve management quality.

*ST Baoqian has been issued negative internal control audit reports for two consecutive years in 2017 and 2018, with problems such as excessive investment, illegal guarantee and delayed information disclosure, which have seriously damaged the interests of minority shareholders and the public and disrupted the normal order of the economic market. In this paper, the problems and reasons of internal control of *ST Baoqian are analyzed and studied, and the improvement measures are put forward, which is beneficial for the company to promote internal control. Therefore, whether from the perspective of reducing financial problems, maintaining the stability of the economic market, or from the perspective of effectively implementing management and reducing the operational risk of the company, it is of certain significance to strengthen the research on the internal control of the company.

2. Problems in Internal Control of *ST Baoqian

On November 24, 2017, *ST Baoqian received the decision of administrative supervision measures ([2017] No. 65) issued by Jiangsu Regulatory Bureau of China Securities Regulatory Commission, which showed that *ST Baoqian's information disclosure had illegal behaviors and internal control had major defects, requiring it to take effective measures in time for rectification. According to the collated information, *ST Baoqian mainly has the following internal control problems:

**The property is hard to be recovered due to the controlling shareholder's misappropriation of assets.** According to the annual report of *ST Baoqian, *ST Baoqian generated a huge amount of receivables and prepayments in the previous year. The receivables balance in 2016, 2017 and 2018 were RMB 1118 million, RMB 534 million and RMB 5 million. However, most of the accounts receivable customers have not been established for a long time, and their operating ability and repayment ability are obviously insufficient. Whether the subsequent accounts receivable can be recovered is still unknown. In addition, *ST Baoqian's prepayments also have some problems. According to the financial data of *ST Baoqian, the balance of prepayments in 2016, 2017 and 2018 was RMB 566 million, 65 million and 8 million. After most prepayments are paid, the counterparties have some unreasonable phenomena, such as non-delivery, under-delivery and even non-execution of contracts. In just one month from November 2017 to December 2017,*ST Baoqian's accounts receivable dropped sharply by RMB 1.916 billion and the prepayments also dropped to RMB 65 million, mainly due to a large amount of bad debt provision made by *ST Baoqian, which affected the company's profit and loss in 2018 by about RMB 758 million. At present, *ST Baoqian’s collection amount is less, the speed is slower, the company's rights is difficult to safeguard, and the internal environment is worrying.

**Over investment and lack of risk assessment.** During the period from 2016 to 2017, *ST Baoqian blindly invested in 9 key projects with a total amount of RMB 3.275 billion, and the relevant responsible persons failed to fully fulfill the audit obligations of these 9 investments. At present, only two investment companies operate normally, and the other seven are almost in a semi-closed state. In addition, *ST Baoqian did not carry out audit and evaluation procedures before buying Liuzhou Yanlong Automobile Co., Ltd. (short name:"Yanlong Automobile") and other six companies, and there was no basis for pricing transactions, which caused *ST Baoqian to pay more equity consideration. Due to unreasonable investment, decision-making procedures and inflated transaction
prices, most investment companies are now in a state of losing contact and out of control. As a result, the provision for impairment of goodwill and long-term equity investment in 2017 reached RMB 3.779 billion, and the provision for long-term equity investment in 2018 was supplemented by about RMB 63.3 million.

**Take seal without permission for illegal guarantee.** According to the announcement of *ST Baoqian, Shenzhen Tuyali Special Technology Co., Ltd. (short name: Tuyali) and Shenzhen Baoqianli Electronics Co., Ltd. (short name: Baoqianli Electronics), which are subsidiaries of the company, and the original actual controller Zhuang Min were suspected of taking the company seal for illegal guarantee. From November 2016 to March 2017, Tuyali, Baoqianli Electronics and Zhuang min signed a guarantee agreement with Luoyang Bank Financial Leasing Co., Ltd. to provide guarantee for four companies such as Shenzhen Yunbang Information Technology Co., Ltd. (short name: Yunbang Information) that have signed after-sale leaseback agreements with Luoyin leasing. The amount involved is as high as RMB 450 million. In addition, from February to July 2017, Tuyali, Baoqianli Electronics and Zhuang Min signed a guarantee agreement with Shenzhen Nanshan Baosheng Rural Banking Co., LTD. to provide debt guarantee for Shenzhen Zhihao Supply Chain Co., LTD. (short name: Zhihao Supply Chain) and six other companies that have signed credit agreement with Baosheng Bank respectively. The total amount involved is RMB 305 million. After verification, it is found that the above guarantee is an illegal act against the internal control regulations of the company, not only failed to perform the internal decision-making procedures of the board of directors and the general meeting of shareholders in accordance with the company's regulations, but also avoid the decision-making process, lack of business decision-making, signature, seal and other processes.

3. **Suggestions for Improvement of Internal Control of *ST Baoqian**

3.1. **Decentralize the Stock Rights Reasonably and Improve the Corporate Governance Structure**

A good governance structure cannot be separated from a reasonable decentralized equity structure, Most companies with major internal control problems have excessive concentration of equity. Zhang Min—the *ST Baoqian's original actual controller—grasped the power of the company, leading the company to deviate from its original development goals. In the end, *ST Baoqian went astray and became trapped inside and outside.

Increase the proportion of major shareholders and optimize the equity structure. To establish a good internal control environment, *ST Baoqian should first optimize the equity structure, increase a certain number of large shareholders, and ensure the restriction and balance among shareholders. In order to prevent collusion between the first and second shareholders, it is not only necessary to increase the number of shares held by the second shareholders, but also the checks and balances of other major shareholders. At the same time, in order to avoid the large number of major shareholders and the excessive dispersion of equity, which will reduce the decision-making efficiency of the company, it is advisable to increase the number of major shareholders by two to three.

Carrying out the online voting system and giving play to the restrictive role of minority shareholders. Due to the lack of the right of speech and the asymmetry of information, the minority shareholders of *ST Baoqian often vote with the crowd. In view of this, *ST Baoqian can adopt such methods as teleconference, video conference and online voting, so that minority shareholders
scattered across the country have a certain voice in the board of directors and reduce the manipulation of major shareholders.

3.2. Introducing Professional Talents and Establishing Scientific Risk Evaluation Mechanism

From the business activities such as *ST Baoqian's investment, *ST Baoqian lacks professional talents in risk assessment and obviously lacks awareness of risk prevention. To solve this problem, *ST Baoqian should first set up a special risk assessment department within the enterprise, hire professionals with rich theoretical knowledge and practical experience, and establish a set of risk assessment mechanism suitable for the development of *ST Baoqian with reference to industry standards. When assessing performance, employees who have strong risk awareness and can find potential risks of the enterprise will be rewarded, while those who ignore risks and bring losses to the enterprise will be investigated for responsibility and punished.

Blind decision-making and ignoring investment risk is an important reason for the risk of *ST Baoqian, *ST Baoqian should set up an investment committee to conduct due diligence to assess the feasibility of the investment project and reduce the hidden risk as much as possible. In the process of investment, enterprises should strengthen post investment management and timely adjust investment decisions according to changes in market environment.

3.3. Strengthen the Management of Seals and Perfect the Control Procedures of Guarantee Activities

In order to avoid the reoccurrence of the event that the majority shareholder takes the seal to guarantee privately, *ST Baoqian should strengthen the control of the seal. When the seal is kept, each seal shall be kept in a special counter and monitored 24 hours. When using the seal, the user department should submit an application with relevant seal materials, and the application should indicate the applicant, the reason for using the seal, the time of using the seal and the approval opinions of the leader. The seal keeper should strictly examine the application form, register and keep the seal usage data for reference.

*ST Baoqian should improve the control procedure of guarantee business and prohibit illegal guarantee behavior. First, the legality and acceptable risk level of the guarantee business should be preliminarily assessed, and the scope of authority, handling process and approval procedures of the positions involved in the handling of the guarantee business should be clarified. Each position can continue to handle the guarantee business only after being authorized and approved. Second, the board of auditors, the internal control department and the corporate lawyer should review the proposed contract terms. Anyone has to sign the guarantee contract in the name of the enterprise after review. Third, the important guarantee business needs to be examined and approved by the responsible person of each department level by level, and the joint signature shall be implemented if necessary; the guarantee contract that needs to be voted by the general meeting of shareholders or the board of directors shall be signed only after the voting procedure is carried out.

3.4. Carry out Effective Supervision and Inspection

3.4.1. Strengthen the Supervision and Restriction Function of Independent Directors

The introduction of independent director system in listed companies is to require independent directors to play an effective role in restriction and supervision. However, the number of independent directors of *ST Baoqian is small and there is a suspicion of following the crowd in voting. *ST
Baoqian should perfect the independent director system and give full play to the supervision role of the independent director. On the one hand, we can appropriately increase the number of independent directors to ensure that independent directors can balance the interests of major shareholders. On the other hand, it is necessary to link the frequency of independent directors' participation in the meeting with salary incentive, so as to improve the enthusiasm of participating in the meeting.

3.4.2. Play the Role of the Board of Auditors

All members of *ST Baoqian's internal audit should have sufficient financial experience and professional skills, high sense of responsibility and independence of practice. When the audit is completed, the internal auditor should timely feedback the audit results to the management. Then they should evaluate the performance of internal control of each department and put forward corresponding improvement measures. In addition, *ST Baoqian's management at all levels should actively cooperate with the work of the audit committee, the company should also scientifically assess the work of internal auditors, and constantly improve the internal control mechanism of mutual supervision and mutual restriction.

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